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August 12, 1986

VIA MESSENGER

Benjamin H. Vogler, Esquire
U.S. Nuclear Regulatory Commission
8th Floor, Rm. 8211
7735 Old Georgetown Road
Bethesda, Maryland

Re: Alabama Power Company
(Farley Nuclear Station, Units 1 and 2)

Dear Mr. Vogler:

As stated to you in a recent meeting, Alabama Power Company ("APCO") strongly perceives a need for some form of assurance that Alabama Electric Cooperative ("AEC") will meet its obligations under project agreements for its participation in ownership of Plant Farley. APCO is prepared to accept guarantees by AEC's member cooperatives and to structure the guarantees so that a cooperative's obligations to APCO are subordinate to its mortgage obligations both to the REA and the National Rural Utilities Cooperative Finance Corporation ("CFC").

You have requested that APCO address two matters that were raised during our meeting. The first concerns the nature of the Wholesale Power Contracts ("Contracts") between AEC and its members, and the second concerns AEC's claim that these contracts have been accepted by private sector lenders as security for loans to AEC and other generation and transmission cooperatives.

The Contracts

I have enclosed REA Form 444, which is the standard form of Wholesale Power Contract recommended by the REA (Attachment A). I believe that AEC's contracts with its members substantially conform to this sample.

APCO calls your attention to two provisions of the Contract. First, Section 1 obligates the Member to purchase its requirements of power "to the extent that the Seller shall have such power

and energy and facilities available." Second, the payment provision, Section 4, obligates the Member only to "pay the Seller for all electric power and energy furnished hereunder." Obviously, these provisions do not assure that payment will be received when the Seller's facilities have been disabled or retired from service.

By way of contrast, I have enclosed some materials concerning the arrangements among Florida Municipal Power Agency ("FMPA"), its member Cities, and Florida Power & Light Company ("FPL") concerning joint ownership of St. Lucie Unit No. 2. The FMPA Preliminary Official Statement explains the terms of the contracts between FMPA and its members (Attachment B at p. 6). The members pay under a Power Sales Contract for power and energy provided to them. If power is not provided, the member nonetheless must pay FMPA the same amount of money under a Project Support Contract, which payments "are required to be made whether or not the St. Lucie Project is completed, operable or operating and notwithstanding the suspension or interruption of output of the St. Lucie Project." (Id.; see also p. D-16 "Obligation of Each Participant" and p. D-19 "Payments by Each Participant.") This is known as a "hell or high water" clause, and it is apparent that the AEC Contract has no such provision.

Even though the arrangements between FMPA and its members include "hell or high water" provisions, it is necessary to guard against self-dealing between the parties to the contract. Enclosed, as Attachment C, is Section 43 of the Participation Agreement between FMPA and FPL which grants FPL third party beneficiary status under the FMPA/member City contracts and assures that those contracts will remain in effect and be enforced.

The St. Lucie arrangements are equivalent to the AEC Member guarantees sought by APCO in this case. The Wholesale Power Contracts between AEC and its Members may well meet the limited needs of the REA, which, under its mortgages, exercises pervasive control of both AEC and the Member cooperatives.*/ However, as demonstrated in the section that follows, these Contracts are given virtually no weight by private lenders.

Security for Borrowing by G&T Cooperatives

You have supplied us with an affidavit by Charles B. Gill, Governor and Chief Executive Officer of CFC, who asserts that the "all-requirements power contract between the G&T and the

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*/ For example: (1) no cooperative may enter into or change a significant contract without REA approval; (2) any contract for the sale or purchase of power is itself pledged under the mortgage; and (3) in the event of default REA can take over management of the cooperative and correct the default.

distribution system has been the base security instrument underpinning $45 billion of investment at the G&T level." This implies that lenders have been willing to provide funds on the basis of these contracts. The information available to us indicates that the facts are otherwise.

The information available to us is that all long term G&T cooperative financing has its source either in loan guarantees from the REA or loan guarantees from CFC. We have enclosed, as Attachment D, CFC's Form 10-K for 1985. It reveals, on page F-3, that, as of May 31, 1985, CFC's assets include $1,147,713,000 of "Total Members' Subordinated Certificates and Members' Equity."*/

CFC's "Loan and Guarantee Policies" are described in a section that begins on page 7 of the 1985 10-K. This discussion indicates that "most loans to CFC member power supply systems for new generating plants and transmission facilities ... have been made ... under repayment guarantees from the REA." (p. 8). To the extent that other long term mortgage loans have been made by CFC, "[v]irtually all of [them] are secured by a first mortgage lien upon all property ... at any time owned by the borrower," under circumstances in which REA has agreed that "CFC may share ratably (with REA) in the security provided by the mortgaged property." (p. 9). Intermediate term loans -- for up to 5 years -- are made available if secured by: "(i) a first mortgage on a parity with other lenders, such as REA on substantially all of the mortgagor's assets; (ii) a first mortgage on the property being financed; or (iii) a suitable guaranty of repayment of the loan from a third party." (p. 9).

At pages 10-11 of the 10-K, it is explained that loan guarantees extended by CFC are secured by mortgage liens on the property involved, again under circumstances in which the REA has agreed to permit CFC to stand on an equal footing with it.

We have reviewed some recent examples of loans obtained by G&T cooperatives under the CFC guarantee program, and have attached (as Attachment E) an Official Statement for such a loan obtained by Seminole Electric Cooperative, Inc. The security for the Seminole loan consisted of, among other things: (i) a debt service reserve fund of $13,500,000 (9% of the principal of the loan) (p. 3); (ii) an unconditional guarantee of payment by CFC, backed by its over one billion dollars of equity (p. 15), and (iii) a mortgage lien, in parity with the REA, on all of Seminole's assets (pp. 16-17).

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*/ It is explained, in footnote 3 to CFC's Financial Statements on page F-12, that any G&T Cooperative obtaining a loan or loan guarantee generally is required to purchase "Subordinated Certificates" in amounts between 2% and 10% of the principal of the loan.

Contrary to what is implied in Mr. Gill's affidavit, private lenders apparently are not prepared to rely on the Wholesale Power Contracts between G&T cooperatives and their members, a fact that certainly must be known to Mr. Gill, who signed the 10-K to which extensive reference is made above. Viewed in the light most favorable to AEC, the material provided to the NRC Staff by AEC is incomplete on the subject of financial security to the point of misinforming the Staff.

APCO is requesting much less security than appears to be demanded by any financial institution lending money to a G&T cooperative. APCO does not request a mortgage lien or a guarantee by REA or CFC (although APCO would be satisfied by a guarantee from either). It simply asks for a subordinated right to look to the beneficiaries of AEC's ownership in Plant Farley if AEC fails to meet its obligations.

AEC contends that even this security has not been provided in the past. It neglects to add that (1) most of the nuclear participation arrangements entered into by G&T cooperatives were consummated prior to the incident at Three Mile Island, which brought home the realization of the unpredictable financial risks associated with a nuclear plant; (2) most such arrangements were negotiated on a commercial basis and have involved large fees or price markups for the seller; and (3) while most people in the utility industry assumed, in the past, that the REA would act to prevent the failure of a G&T cooperative, in the past two years one G&T cooperative (Wabash Valley) has sought protection under the bankruptcy laws and at least three others have announced that insolvency may be imminent.

It is quite apparent that the NRC Staff, when it issued the Notice of Violation, had been misinformed by AEC. We urge you to reconsider your position in light of the new information transmitted with this letter.

Sincerely,

J.A. Bouknight, Jr.

Attorney for
Alabama Power Company

Enclosures

lkf

cc: Robert A. Buettner, Esq.
(with attachments)